United States Court of Appeals

for the Second Circuit

AMICUS BRIEF

74-2343

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IN THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 74-2343

GER-RO-MAR, INC., a corporation, d/b/a Symbra'Ette, now known as Symbra'Ette, Inc., and CARL G. SIMONSEN, individually and as President of Ger-Ro-Mar, Inc., now known as Symbra'Ette, Inc.,

Petitioners,

v.

FEDERAL TRADE COMMISSION,

Respondent.

ON PETITION FOR REVIEW OF ORDER OF
FEDERAL TRADE COMMISSION

AMICUS CURIAE BRIEF OF DIRECT SELLING ASSOCIATION

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Introduction and Factual Background

The Direct Selling Association ("DSA") is a national trade association with offices in Washington, D.C. DSA membership consists of over 100 companies involved in the manufacture and distribution of a variety of products which are sold in the customer's home. DSA is filing this brief to express its concern over the potential impact of the final order and opinion (Rec. 510-40)[1/] issued by the Federal Trade Commission ("Commission"), and to assure that the order and opinion, if affirmed, are confined to the facts of record in this case.

1/ "Rec." refers to the record of proceedings before the Commission. Page numbers appearing in connection with each citation to the record refer to the seriatim repagination of the administrative record prior to this appeal. The particular repagination of each portion of the record is indicated in the documents filed herein on November 18, 1974 by Charles A. Tobin, the Secretary of the Commission.

The portions of the opinion and order relating to recruiting of participants for the Symbra'Ette[2/] plan are extremely broad and general. They were issued in the context of an adjudicative proceeding against a single company which required non-refundable, initial inventory purchases and allegedly promoted its sales plan through misrepresentation of recruiting and earnings possibilities. Rec. 517-20, 523 n.7. Yet, read literally and applied beyond the context of this case, the opinion and order could have an adverse impact upon proper recruiting by countless companies, possibly including some DSA member companies, whose sales plans do not contain such characteristics.

The Commission recognized the importance of recruiting during oral argument in Ger-Ro-Mar's appeal from the administrative law judge's initial decision and requested submission of proposed language for an order which would eliminate the allegedly improper aspects of the Symbra'Ette plan while preserving the opportunity for recruiting. Transcript of March 20, 1974 Oral Argument, at 34-35, 44.[3/] Expressly disclaiming any intention to comment on the merits of the case, DSA then sought to express its concern regarding the scope of the administrative law judge's order in a letter to the

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2/ Ger-Ro-Mar is currently doing business as Symbra'Ette, Inc. and is referred to by the latter name in the Commission's opinion. To avoid confusion, DSA will also use the name Symbra'Ette when referring to the sales plan of the corporate petitioner herein.

3/ This transcript was not repaginated prior to this appeal, although it is included within the record of the Commission's proceedings.

Chairman of the Commission on April 18, 1974. Copies of the letter were served simultaneously upon counsel for the Commission and Ger-Ro-Mar. Notwithstanding these facts, the Commission refused to read or to consider DSA's comments on the ground that the comments constituted "ex parte communication" not entitled to consideration under section 4.7 (16 C.F.R. § 4.7) (1974)) of the Commission's Procedures and Rules of Practice.

Other statements and action by the Commission, its staff, and Ger-Ro-Mar have magnified DSA's concern regarding the potential scope and use of the Commission's final order and opinion. In its brief on appeal from the administrative law judge's decision, the Commission staff indicated its possible intent to use the Commission's final order as a standard for "an industry wide enforcement program." Rec. 461 n.23. The staff has reportedly sought to achieve that goal recently by suggesting the possibility of enforcement proceedings against one or more companies which are not respondents in Ger-Ro-Mar unless those companies' operations conform to the Ger-Ro-Mar order. Ger-Ro-Mar has indicated repeatedly that the order should be applied to its "direct competitors" or, more broadly, to "all open-ended, multi-level marketing plans." See, e.g., Rec. 381, 542-43, 545-49. Finally, the Commission has implied that it will consider application of the Commission's final order and opinion to companies which are not parties to this proceeding. See Rec. 560-61; see also In the Matter of Holiday Magic, Inc., FTC Dkt. No. 8834, Opinion of the Commission at 14 (Oct. 15, 1974) (reprinted at 3 Trade Reg. Rep. ¶ 20,757) (in issuing and discussing a similar order, Commission

noted that it "will consider carefully in the future whether marketing plans of the sort involved here are a suitable target for its newly-gained authority to obtain injunctive relief").

As indicated in greater detail below, the portions of the Commission's order and opinion relating to recruiting of participants in certain marketing plans are manifestly unwarranted, unsupported, and excessive if applied as a binding s[illegible]utside the context of this case. Such sweeping orders and [illegible]ns may be justified and applied, if at all, only in the context of a specific adjudicative or rulemaking proceeding in which all interested persons have an opportunity to be heard. Accordingly, while DSA does not wish or intend to comment upon the facts of record in this case, DSA does wish to ensure that the opinion and order, if affirmed, are based upon, and limited to, those facts. Only in that way may the Court protect the rights of any interested DSA member companies and others to a fair and full hearing in future Commission adjudicative or rulemaking proceedings, if any, which may affect them directly.

Argument

The Commission has two primary means by which it may enforce section 5 of the Federal Trade Commission Act (15 U.S.C. § 45 (1970)): adjudicative proceedings against one or more respondent individuals, partnerships, or corporations; and rulemaking proceedings, in which the Commission promulgates

general standards applicable to every individual, partnership, and corporation engaged in the conduct which is the subject of the rule.[4/] Both alternatives require Commission adherence to rigorous procedural requirements which are essential to due process of law. See 5 U.S.C. §§ 553-54, 556-57 (1970) and (Supp. III, 1973) (Administrative Procedure Act); 15 U.S.C. § 45(b) (1970) (Federal Trade Commission Act); 16 C.F.R. §§ 1.11-1.12, 1.15-1.16, 3.1-3.2, 3.11-3.15, 3.21-3.24, 3.31-3.39, 3.41-3.46, 3.51-3.55 (1974) (Procedures and Rules of Practice for the Commission). These requirements direct, inter alia, that the Commission provide notice and an opportunity to be heard to parties who will or may be affected by proposed Commission action.

The Commission has discretion in choosing between rulemaking and individual adjudicative proceedings in carrying out its enforcement responsibilities. That discretion should, however, be exercised carefully and subject to critical judicial review where, as here, the Commission seeks to establish novel, innovative, and sweeping legal standards.

Rulemaking may be the more appropriate and fairer procedure in such instances, since it permits all interested parties to submit relevant arguments and information for the Commission's consideration and thereby encourages more informed administrative

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4/ For an extensive discussion and recognition of the Commission's dual enforcement authority, see National Petroleum Refiners Ass'n v. FTC, 482 F.2d 672 (D.C. Cir. 1973), cert. denied, 415 U.S. 951 (1974).

decision-making. E.g., NLRB v. Wyman-Gordon Co., 394 U.S. 759, 764 (1969); Bell Aerospace Co. Div. of Textron Inc. v. NLRB, 475 F.2d 485, 495-96 (2d Cir. 1973), aff'd in part and rev'd in part, 416 U.S. 267 (1974); National Petroleum Refiners Ass'n v. FTC, 482 F.2d at 682-84.[5/] If, on the other hand, the Commission elects to formulate standards through adjudicative proceedings against individual companies, it must "proceed with caution, developing its standards in a case-by-case manner with attention to the specific character" of the facts in the proceeding before it. NLRB v. Bell Aerospace Co., Div. of Textron, Inc., 416 U.S. 267, 294 (1974); cf. FTC v. Colgate-Palmolive Co., 380 U.S. 374, 394 (1965) ("[t]he propriety of a broad order depends upon the specific circumstances of the case").[6/]

This attention to the facts of the case before it is particularly important where the Commission's adjudicative order and opinion have potential ramifications for numerous other

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5/ Rulemaking also prevents the unnecessary expenditure of time and money involved in case-by-case adjudicative proceedings; permits adoption of more specific and enforceable standards; provides more certainty concerning the individuals and firms subject to the standards adopted; and avoids contentions of selective enforcement such as those raised by Ger-Ro-Mar before the Commission. E.g., National Petroleum Refiners Ass'n v. FTC, 482 F.2d at 681-84, 690-91.

6/ Congress emphasized the critical importance of careful attention by the Commission to the facts of a particular situation in enacting the Federal Trade Commission Act. The legislative history of that Act clearly indicates that, whatever enforcement technique it adopts, the Commission must consider "the special circumstances of individual businesses in proceeding against them" and avoid treating "varying business practices or [companies] in a fashion that fails to appreciate relevant distinctions among them." National Petroleum Refiners Ass'n v. FTC, 482 F.2d at 692, 705.

companies and industries. In an adjudicative proceeding, unlike rulemaking, only "[t]hose most immediately affected, the [respondents] in the particular case, are accorded a full opportunity to be heard before the [Commission] makes its determination." NLRB v. Bell Aerospace Co., Div. of Textron, Inc., 416 U.S. at 295. Thus, settled principles of administrative law dictate that the Commission's decisions be rigorously scrutinized upon review to assure that a sweeping opinion and order issued in an adjudicative proceeding against a single company not be affirmed in a fashion which goes beyond the facts of record and permits the Commission effectively to limit or to eliminate the right of other companies to be heard in any future Commission proceedings which directly affect their interests.[7/]

Analysis of the portions of the Commission's opinion and order relating to recruiting under the Symbra'Ette plan will demonstrate the importance of careful judicial review in this proceeding.

The Commission concluded that the Symbra'Ette plan was inherently unfair and deceptive in violation of section 5 of the Federal Trade Commission Act. Rec. 525. This conclusion was based, the Commission asserted, on the fact that Symbra'Ette "held out" as a "reasonable business opportunity" a plan in which a

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7/ DSA recognizes that the Commission's opinion and order, if affirmed and enforced, are not technically binding under the principle of stare decisis upon companies which are not parties to this case. If, however, the Court affirms the sweeping opinion and order without limiting its decision to the facts of record in this case, the practical, limiting effect of the Court's decision upon the rights of such companies in any future Commission proceedings should not be underestimated.

participant's compensation was represented to be and was based at least in part upon the unlimited or "ad infinitum" recruitment of other participants:

> [S]ince the linchpin of the system is that those at the beginning will be able to succeed by promising others the ostensibly lucrative right to build their own network of recruits, and so on without end, there arises a substantial likelihood that at some point the representation that the plan affords a reasonable business opportunity will be made to individuals to whom it will appear plausible, but for whom it will be blatantly untrue, by virtue of the fact that the universe of potential recruits (which is much, much smaller than the universe of potential consumers) has been effectively exhausted. Rec. 522.

> Any plan which holds out the opportunity to make money, by means of recruiting others, with that right to recruit being passed on as an inducement for those others to join, and being passable by them ad infinitum contains this intolerable potential to deceive, quite apart from whatever particular representations may be made in promoting the plan. Rec. 525 (initial emphasis added).

Although its reasoning is not entirely clear, the Commission was apparently concerned about one or both of two alleged injuries to participants in the Symbra'Ette plan. First, the participants allegedly suffered a financial injury through the initial investment in inventory required to become a participant in the plan. Rec. 517, 520, 530, 534. Second, the participants allegedly suffered at least a potential injury to their expectations by participating in a sales plan which, the Commission believed, would inevitably fail to provide the unlimited recruiting opportunities which it allegedly held out implicitly and through explicit representations. Rec. 524, 526, 528, 531.

Neither alleged injury cited by the Commission is necessarily inherent or unavoidable in "any" sales plan which offers participants some form of compensation based upon recruiting and imposes no arbitrary limits upon such recruiting. The potential for financial injury cited by the Commission might, for example, be negligible or nonexistent in a plan which required no initial inventory purchase or other payment and which guaranteed the repurchase of any inventory held by a participant who left the plan. Cf. Rec. 529 (repurchase provision "should help remedy any injury done to distributors who enter the program as a result of deception").

Similarly, one can imagine a system of affirmative disclosures and representations which would clearly advise participants that recruiting in a sales plan was not, in fact, unlimited even if no arbitrary limits were imposed upon the number of recruits. Such disclosures and representations might arguably be ineffective concerning a sales plan about which misrepresentations had already been made, as contended by the Commission. Rec. 525. They could, however, be entirely effective in more favorable circumstances involving no misrepresentations, since a prospective participant's expectations would inevitably be formulated and tempered by the manner in which the plan was presented and by his knowledge that no product, service, or sales plan will be attractive to every person whom he contacts. Stated more directly, such plans would not "hold out" the possibility of unlimited recruiting and could not reasonably be construed as doing so. Thus, the Commission's apparent disapproval of "any" plan which does not arbitrarily

limit recruiting is manifestly overbroad and unwarranted by the record in this case which involves a single sales plan, non-refundable initial inventory purchase requirements or possibilities, and alleged misrepresentations concerning potential recruiting and earnings. Rec. 517-20, 523 n.7.

The portions of the Commission's order relating to recruiting are as overbroad and unsupported as its opinion, especially if applied beyond the context of this case. Paragraph one of the order broadly prohibits any future Symbra'Ette plan in which a participant pays "a valuable consideration in return for the opportunity to receive compensation for inducing other persons to become participants in the plan or program . . . ." Rec. 511 (emphasis added).[8/] The order makes no attempt to define the term "valuable consideration." The opinion also fails to provide any reliable guidance on this issue, although one portion of the opinion might be construed to apply paragraph one even in situations where the only consideration paid by the participant was the purchase of sales materials for a nominal amount at cost. Rec. 530.

Such inclusion of sales materials furnished at cost (i.e., at no profit to the company) within the definition of

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8/ The term "compensation" is defined to exclude payments based on "actually consummated" retail sales to persons who are not currently participants in the plan and who are not purchasing goods or services in order to become participants. Id.

"valuable consideration" is, at best, questionable under any circumstances. Sales materials are a vital part of many commercial enterprises, and a company may hardly be expected to operate long or to injure participants if it obtains no profit from the only consideration which participants pay to enable them to sell products. The Commission effectively agreed with this analysis only three months after issuing its Ger-Ro-Mar order; in its order against a sales plan of which it was most critical, the Commission explicitly permitted the organizers of the plan to offer "reasonably necessary sales materials" at "actual cost." In the Matter of Holiday Magic, Inc., FTC Dkt. No. 8834, Final Order Part II, ¶ 3 (Oct. 15, 1974). Where, as here, the Commission's order is more severe and less flexible than a "virtually contemporaneously declared" order in another proceeding, this order should be reviewed with particular care and should clearly not be applied beyond the context of this case. Cf. Marco Sales Co. v. FTC, 453 F.2d 1, 7 (2d Cir. 1971).

Paragraph two of the Commission's order relates even more directly to recruiting under the Symbra'Ette plan. This paragraph prohibits Symbra'Ette, in operating any sales plan which provides some form of financial incentive for recruiting, from maintaining a plan with more than three tiers of participants for a period of one year. Moreover, the paragraph restricts "third-tier" participants from engaging in any recruiting activities

during that period.[9/] Rec. 511.

Basically, paragraph two "is addressed to the problem of unlimited recruitment." Rec. 530. It is designed, the Commission explained, to eliminate any alleged deception which might remain even in a plan in which a participant's compensation for recruiting is based solely upon his recruits' retail sales:

> [T]he possibility of deception remains, because . . . the individual may be induced to buy inventory on the mistaken assumption that he or she can delegate the retailing function to later generations of recruits, each of which may enlist for similar mistaken reasons. Rec. 530.

However, the Commission has stated absolutely no basis or reason for its arbitrary imposition of a three-tier, one-year limitation upon recruiting. While the Commission's opinion is filled with references to the alleged undesirability of unlimited recruiting, it is devoid of any indication why only plans involving three or less tiers of participants are acceptable to the Commission.

9/ The order and opinion do not state whether participants recruited by "current" third-tier participants after one year may recruit others immediately or whether they, too, must complete a one year "waiting period" before recruiting. Neither do they specifically indicate whether third-tier participants (or subsequent recruits) may then obtain compensation based on their recruits' retail sales. Finally, the order and opinion are ambiguous as to the duration of the "three-tier" limit on recruiting. While DSA assumes that the plan could grow at least by one tier per year, some statements in the Commission's opinion might be characterized as implying an indefinite three-tier limit. E.g., Rec. 531.

The opinion states only that the three-tier limit was adopted "to create a substantial interruption in the chain of recruitment" and thereby allegedly "ensur[e] that the system must be presented to potential participants in a way which makes clear that their profits will depend directly on their own efforts in retailing to consumers or in building a retail organization." Rec. 531; see also Rec. 557-58. It contains no statement to support the Commission's apparent view that these objectives, if valid, may be achieved only by the arbitrary imposition of a three-tier limit on recruiting. Thus, the Commission has, without explanation, required Ger-Ro-Mar to adopt a three-tier sales plan merely because it concluded that unlimited recruiting was unacceptable.

Fundamental principles of administrative law, as reflected in the Administrative Procedure Act, require that an administrative agency state the basis and reasons for its conclusions and orders;[10/] without such a statement effective judicial review is impossible. E.g., NLRB v. Bell Aerospace Co., Div. of Textron, Inc., 416 U.S. at 289-90, aff'g 475 F.2d at 494-95; SEC v. Chenery Corp., 318 U.S. 80, 94-95 (1943). The Commission is subject to this requirement like any other agency. Where it has failed to articulate the bases or reasons for its action or those bases or reasons are erroneous, remand to the Commission is required. FTC v. Sperry & Hutchinson Co., 405 U.S. 233, 248-49

10/ 5 U.S.C. § 557(c) (1970).

(1972); see Marco Sales Co. v. FTC, 453 F.2d at 7.[11/] Accordingly, there is a substantial question whether paragraph two of the Commission's order is susceptible to effective judicial review or sustainable in this case, and it is overwhelmingly clear that this portion of the order is inappropriate for application in other situations.

The Commission's discussion of paragraph two suggests a further reason why imposition of an arbitrary, three-tier limit on recruiting is improper and unnecessary. The Commission briefly considered imposition of detailed disclosure requirements as an alternative to arbitrary limits on recruiting to eliminate any allegedly inherent deceptiveness in the Symbra'Ette plan. In rejecting that approach, the Commission conceded the "theoretical possibility" of devising disclosures which would eliminate the unfairness and deceptiveness that allegedly existed. It rejected that possibility with respect to the Symbra'Ette plan, however, because of its doubts whether such disclosures would and could be adopted and fully implemented "in the real world." Rec. 525.

11/ One may fairly question whether the Commission even acknowledges its obligation to state the basis and reasons for limiting a distribution system to three tiers. In denying reconsideration of a related portion of the order, the Commission noted that "respondents have not suggested in any way why it is not reasonably related to the findings in this matter or the scope of the complaint." Rec. 557 (emphasis added). If this statement was intended to suggest that the Commission may adopt and enforce particular remedial provisions without explanation, absent proof by the respondent that those provisions are unnecessary or unreasonable, it reflects a totally unsupportable assertion of administrative authority.

Despite the Commission's misgivings, it is entirely possible to conceive of sales plans, involving other companies and industries, which might fairly and accurately reflect the opportunity for recruiting under those plans without artifically and arbitrarily limiting recruiting to three tiers of participants. Conversely, it is at least not impossible that such plans might exist. See pages 9-10 supra. Such other companies and industries are entitled to an opportunity to present the details of their own sales plan before operation of their plan is restricted. The record in this proceeding relates only to the facts concerning one particular sales plan which involved an initial, non-refundable investment in inventory and alleged misrepresentations concerning recruiting and earnings. Paragraph two of the Commission's order should be reviewed and, if affirmed, applied only in that context.

Conclusion

Recruiting of a large and qualified sales force is essential to many commercial enterprises. It is particularly important in the area of direct selling, since a direct seller's potential customers must be contacted in their home, rather than at a limited number of sales outlets requiring a smaller sales force.

The opinion and order presently before the Court were adopted in the context of an adjudicative proceeding in which only the respondents were permitted to submit evidence and to be heard. Yet those rulings have ramifications which potentially extend far beyond the context of this case.

Except as specifically indicated above, DSA does not wish or intend to comment upon the propriety of the order and opinion in this case or upon the procedures by which the order and opinion were adopted. Neither does DSA request the Court to take such action as might be necessary to confirm the propriety of any sales plan not involved in this proceeding. DSA merely requests that the Commission's opinion and order be limited to the facts of record herein, thereby protecting the opportunity and right of other companies effectively to present evidence and arguments in any future Commission proceeding which directly affects their interests.

Respectfully submitted,

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